No. 15781

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ELIAS MILLER, PAUL MILLER, ANNA MILLER and HELEN MILLER, and ELIAS MILLER and PAUL MILLER, as Executors of the Estate of George Miller, Deceased,

Appellants,

vs.

IRVING SULMEYER, Trustee in Bankruptcy of the Estate of Delcon Corporation, Bankrupt,

Appellee.

Appeal From the United States District Court for the Southern District of California, Central Division.

PETITION FOR REHEARING OR REVISION OF COURT'S OPINION AND DECISION.

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PETITION FOR REHEARING OR REVISION OF COURT'S OPINION AND DECISION.

Appellants (referred to herein occasionally as Millers), respectfully petition this Honorable Court for a rehearing, or revision of its opinion and decision filed herein on January 16, 1959. This petition is predicated on the following briefly and concisely stated grounds, which the opinion of the Court indicates were not considered by it, though same had been presented and argued by appellants at the oral argument.

We respectfully submit and urge this Honorable Court to reconsider its decision in the light of the applicable equitable principles of subordination expounded by the

United States Supreme Court in *Pepper v. Litton,* 308 U. S. 295, 60 S. Ct. 238, and by this Honorable Court in *Bank of America v. Erickson,* 117 F. 2d 796 at 798, which authorities were submitted by appellants at the oral argument. We wish to stress the further point that under the undisputed facts in this case and in the light of the opinion of this Court the fund realized by appellants upon the sale of the property covered by the instant chattel mortgage must be impressed with an *equitable lien* in their favor on the ground and under the equitable doctrine of unjust enrichment sought by the trustee, which was appropriately characterized by the Court as a "windfall" (p. 2, Opin. last par.). We respectfully submit that the claims of the creditors who came into existence after the perfection of Millers' chattel mortgage (when the bankrupt was solvent), in equity and good conscience must be subordinated to Millers' aforesaid equitable lien.

Brief Résumé of the Operative Facts.

The operative facts are clearly stated in the Court's opinion and the glaring inequities of the Trustee's position need not be repeated. However, a brief restatement thereof may serve to clarify and facilitate a clearer understanding of our contention that the *Moore v. Bay* decision of the United States Supreme Court (284 U. S. 4) is not applicable to the equitable situation presented by this record. Bearing on the inequities of the "windfall," sought by the trustee the following operative facts bear emphasis:

1. Millers' purchase price chattel mortgage was recorded on August 19, 1954, more than four months preceding the filing of the bankruptcy petition; the creditors who came into existence after the recordation of the

chattel mortgage had constructive notice of the Millers' purchase price chattel mortgage lien.

2. The chattel mortgage was recorded *when the bankrupt was solvent*; and the execution and recordation thereof, therefore, *did not constitute a preference* under 11 United States Code, par. 96 (Bankruptcy Act, par. 60) *as to any of the bankrupt's creditors.*

3. The judgment of the District Court awarding a *personal judgment* against Millers in the sum of $82,500.00, enabled the creditors who came into existence after the recordation of the chattel mortgage (of which they had constructive notice more than four months preceding bankruptcy) *to become unjustly enriched* in that amount.

Equitable Principles.

1. Unjust enrichment is condemned by the California law, by which the substantive rights of the bankrupt's creditors are weighed and measured. The equitable doctrine precluding unjust enrichment is invoked by the California law regardless of the claimed legal invalidity of the instant chattel mortgage lien on the ground of its belated recordation.

2. The doctrine of unjust enrichment is rooted in the fundamental concept that courts of equity seek to do justice and equity and prevent unfair results.

3. An equitable lien is not a contractual lien; it is a creature of equity; the right of a creditor to have a certain fund or specific property applied to payment of his debt rests on the equitable doctrine precluding unjust enrichment; and the object of an equitable lien is to prevent an inequitable assertion of rights resulting in unjust enrichment.

4. Courts of Bankruptcy are courts of equity; in the exercise of their equity jurisdiction bankruptcy courts are governed by equitable principles; the right of subordination is an equitable doctrine; and it exists to prevent inequitable results, regardless of the question of equitable liens.

5. Moreover, the equitable doctrine precluding unjust enrichment creates an equitable lien. It is a concept of recent progressive development and gradual proliferation; it is in the nature of a constructive or involuntary trust; and is invoked by courts of equity in the exercise of their equity jurisdiction.

6. The *Moore v. Bay* decision did not discuss or adjudicate rights of equitable lien creditors to subordination. Assuming *arguendo* (but not conceding) that (as this Honorable Court stated in its opin. at p. 4, second par.), that the *Moore* case could not be distinguished *"in principle"* from the case at bar, it is appellants' principal contention that the *legal* principles therein announced must yield to *the equitable principles* of subordination explicated in the decisions cited below.

7. While under Section 60(6) of the Bankruptcy Act an equitable lien is not recognized "where available means of perfecting *legal liens* have not been employed," (emphasis added) such does not destroy the right of an equitable lien creditor to priority of payment over simple creditors who came into existence after recordation of his legal lien within more than four months preceding bankruptcy and when the bankrupt was solvent.

ARGUMENT.

Initially we wish to re-emphasize the point that the *legal* factual situation presented in the *Moore v. Bay, supra,* is not comparable to the *equitable* factual situation presented by this record for the reasons pointed out in appellants' closing brief beginning at page 5. We respectfully submit that the statement in the opinion that the *Moore v. Bay* decision cannot be distinguished "in principle" from the case at bar is an incorrect statement of the law in the light of this record. We wish to re-emphasize further that the analysis made by the Referee of the decision in *Moore v. Bay* in its application to the present equitable factual record finds conclusive support in the underlying equitable philosophy of the Bankruptcy Act clearly explored by the Referee in his memorandum decision. However, these points have been adequately covered by appellants in their opening and closing briefs; and for this reason we would not be justified to burden this court with an additional argument on these points.

This petition is therefore addressed to the following major and subsidiary contentions which were stressed by appellants at the oral argument, but which were not passed upon by this Honorable Court in its opinion.

These several contentions we respectfully submit go to the very heart of the trustee's case. They merit careful consideration and study in view of the shocking inequities of the trustee's position; and same are presented in the following order.

I.

The Equitable Principles Which Govern in the Allowance, and Disallowance or Subordination of Claims in Bankruptcy Were Discussed in Our Oral Argument Before This Honorable Court on July 10, 1958.

At the oral argument we called the Court's attention to *Pepper v. Litton,* 308 U. S. 295, 60 S. Ct. 238 and *Bank of America v. Erickson,* 117 F. 2d 796 at 798; and we stated that the Supreme Court in *Pepper v. Litton, supra,* had modified or relaxed the harsh legal rule of law announced in *Moore v. Bay.*

In *Moore v. Bay,* the Supreme Court said:

> "The Circuit Courts of appeal seem generally to agree, as the language of the bankruptcy act appears to us to imply very plainly *that what thus is recovered for the benefit of the estate is to be distributed in dividends of equal per centum on all allowed claims, except such as have priority or are secured.*" (Emphasis ours.)

Eight years later the Supreme Court announced the equitable rule of law governing the equitable powers of courts of bankruptcy relating to *distribution* of bankruptcy funds to creditors. The Court said:

> "The bankruptcy courts have exercised these equitable powers in passing on a wide range of problems arising out of the administration of bankrupt estates. They have been invoked to the end that fraud will not prevail, *that substance will not give way to form, that technical considerations will not prevent substantial justice from being done.* By reason of the express provisions of §2 these equitable powers are to be exercised on the allowance of claims, a conclusion which is fortified by §57, sub. k, 11 U. S. C. A.

> §93 sub. k.12. For certainly if, as provided in the latter section, a claim which has been allowed may be later 'rejected in whole or in part, according to the equities of the case,' disallowance or *subordination in light of equitable considerations* may originally be made." (Emphasis ours.)

Following this equitable rule, this Honorable Court, in *Bank of America v. Erickson,* 117 F. 2d 896 at 898, said:

> "The bankruptcy court has undoubted power to subordinate a general claim to other claims in the same category where for any reason, legal or equitable, it ought to be subordinated."

Therefore, under the authority of *Pepper v. Litton* and *Bank of America v. Erickson, supra,* the bankruptcy court has the "undoubted power" to subordinate one or more general claims to others of the same classification where for any reason, legal or equitable, they should be subordinated.

In other words, the Supreme Court, in *Moore v. Bay,* holds that creditors *of the same classification* must be paid equal dividends; and later, in *Pepper v. Litton,* the Supreme Court holds that under the equitable principles of the bankruptcy law, the bankruptcy court has the power to subordinate claims whenever they should be subordinated.

In *Moore v. Bay,* the Supreme Court had before it a strictly legal question, whereas, in *Pepper v. Litton,* it was dealing with equitable principles of the bankruptcy law which govern in the allowance of claims.

II.

This Honorable Court Has Power, and Should, Under the Evidence, Subordinate the Claims of Creditors Which Were Contracted Subsequent to the Recordation of the Miller Mortgage.

We believe and respectfully submit that the facts in this case require and demand the application of the equitable principles of subordination of claims enunciated in *Pepper v. Litton,* 308 U. S. 295, 60 S. Ct. 238, and by this Honorable Court in *Bank of America, etc., v. Erickson,* 117 F. 2d 796 at 798.

The Referee, in his memorandum opinion, says: "We have here a situation which literally shocks the conscience of the Referee. . . ." If we interpret the views of this Honorable Court correctly from the language of its opinion, it felt much the same way, but felt bound to follow the ruling in *Moore v. Bay,* 284 U. S. 4.

Had the equitable principles announced in *Pepper v. Litton* and *Bank of America, etc., v. Erickson,* above cited, entered the mind of the Referee while he was writing his opinion, it is obvious, we believe, that he would have subordinated the claims of creditors of the bankrupt which were contracted *after the recordation of the Miller chattel mortgage* to the other general claims, including the Miller claim.

It is clear that the result which the order of the Referee would have accomplished is exactly the same as it would have been had he held that the instant chattel mortgage was void under *Moore v. Bay,* and yet under the equitable power of the court, subordinated these late claims to

those of the other general creditors. Such a ruling would have been safe from the attack of the trustee under the evidence of the case and under the law above cited.

We believe, therefore, that this Honorable Court has the power and duty to subordinate these late claims, or at least to refer this matter back to the District Court for a further hearing upon the issue of subordination. Certainly appellants should not be denied a hearing upon the question of the subordination of the late claims. There was no necessity of raising the issue of the right of subordination before the Referee in the first instance because his order granted the necessary relief to the appellants. It would not now become so important except for the limited remand of the District Court hereinafter mentioned were it not for this limited remand, appellants would have the desired remedy under Section 57(k) of the bankruptcy act.

III.

The District Court, by the Nature of Its Order, Should Not Have Foreclosed the Right of Any Interested Party to Petition the Referee for an Appropriate Order of Subordination.

The order of the District Court remanded the case to the Referee for the *sole* purpose of determining whether appellants were entitled to certain credits against the judgment in favor of appellee.

Were it not for this order limiting the purpose of the remand, appellants would still be free to go before the Referee and petition for a subordination of the claims which were contracted after the recordation of the chattel

mortgage under *Pepper v. Litton,* and under Section 57(k) of the bankruptcy act.[1] But, we fear that the above limited remand would prevent a further hearing under Section 57(k) of the bankruptcy act. The language would, at least, embarrass the Referee in going forward, and he might be very reluctant to do so, unless this Honorable Court modifies the Order made by the District Court.

IV.

The Fund Realized by Appellants Upon Their Sale of the Mortgaged Property Must Be Impressed With an Equitable Lien in Their Favor.

The doctrine precluding unjust enrichment has been settled in the recent California decisions cited in *Bensinger v. Davidson,* 147 Fed. Supp. 240 at 247. As stated by Judge Carter in the last cited case at page 247:

> "We think the California cases rest on the principle of 'unjust enrichment' and the policy of the law against forfeitures. This language runs through the California cases. We therefore approach the problem on equitable principles. Has Bensinger been unjustly enriched, and if so, by how much?"

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[1]Section 57(k) and (1) provides:

"k. Claims which have been allowed may be reconsidered for cause and reallowed or rejected in whole or in part according to the equities of the case, before but not after the estate has been closed.

1. Whenever a claim shall have been reconsidered and rejected, in whole or in part, upon which a dividend has been paid, the trustee may recover from the creditor the amount of the dividend received upon the claim if rejected in whole, or the proportional part thereof if rejected only in part, and the trustee may also recover any excess dividend paid to any creditor. The court shall have summary jurisdiction of a proceeding by the trustee to recover any such dividends."

In *Bullen v. De Bretteville,* 239 F. 2d 824, this Honorable Court, speaking through Judge Barnes, said at page 831:

> "That an equitable lien may be established, 'in the absence of an express contract, . . . out of general considerations of right and justice as applied to the relationship of the parties and the circumstances of their dealing.'"

In *United States v. Admant Co.,* 197 F. 2d 1, Judge Yankwich speaking for this court said at page 10:

> "[12-14] An equitable lien is a creature of equity. It is the right to have a fund or specific property applied to the payment of a particular debt. It is based on the equitable doctrine of unjust enrichment."

In *Brunson v. Babb,* 145 Cal. App. 2d 214, the California Court said at page 229:

> "Tested by the standard that equity courts look with favor upon equitable liens when employed to do justice and equity, and to prevent unfair results, we are satisfied that, under the facts and circumstances present in the case at bar, the court was justified in finding that an equitable lien was created."

In Restatement of the law on Restitution, par. 160(c) at page 642, it is stated:

> "c. UNJUST ENRICHMENT. A constructive trust is imposed upon a person in order to prevent his unjust enrichment."

In Restatement of the law on Security, par. 59(c) at page 160, it is stated:

> "c. EQUITABLE LIEN. The term 'lien,' in its broadest sense includes equitable liens, which do not depend upon possession. Equitable lien is defined in the Restatement of Restitution, §161, as follows: 'Where property of one person can by a proceeding in

equity be reached by another as security for a claim on the ground that otherwise the former would be unjustly enriched, an equitable lien arises.'"

Pomeroy in Equity Jurisprudence, in interpreting the maxim that he who seeks equity must do equity said in Section 385:

"That whatever be the nature of the controversy between two definite parties, and whatever be the nature of the remedy demanded, the Court will not confer its equitable relief upon the party seeking its interposition and aid, unless he acknowledge and concede, or will admit and provide for, all the equitable rights, claims and demands justly belonging to the adverse party and growing out of or necessarily involved in the subject matter of the controversy."

V.

The Validity of Millers' Equitable Lien Is Not Impaired by Section 60a(6) of the Bankruptcy Act.

It is to be observed that the 1950 amendment to the Bankruptcy Act [60a(6)] *did not indicate a disapproval of all equitable liens.*

(*Cf. Danais v. De Matteo Construction Co.,* 102 Fed. Supp. 874; *Cumberland Portland Cement Co. v. Reconstruction, etc.,* 140 Fed. Supp. 739 at 753; *In re William P. Bray Co.,* 127 Fed. Supp. 627.)

The legislative history of this amendment is explicated in *Cumberland Portland Cement Co., supra* at page 753. *It will be seen that this amendment is aimed solely at preferences;* and same is not concerned with the legal effect of late recordation of Chattel Mortgages under the State law.

In the case at bar the Millers' mortgage *was perfected more than four months prior to bankruptcy and at a time*

the bankrupt was solvent; therefore a preference has not been created.

We respectfully submit that this furnishes an additional potent reason requiring a subordination of these late claims in the light of the authorities cited *supra.*

Conclusion.

In conclusion may we respectfully urge upon this Honorable Court that it modify the judgment of the District Court by directing a subordination of the claims which came into existence after the recordation of the Miller mortgage; or in the alternative it modify the judgment of the District Court in such a manner that it will clearly give appellants the right to petition the Referee to have the late claims subordinated to the payment of other general claims, including their subordination to the Miller claim.

Respectfully submitted,

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Attorneys for Appellants.

Certificate of Counsel.

The undersigned, counsel of appellants, does hereby certify that in his judgment this petition for rehearing or revision of the opinion of this Honorable Court is well founded and same is not interposed for delay.

ERNEST R. UTLEY,

Of Counsel for Appellant.